MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2022/2023 (TERM ID 2210)

BFN3034 - BEHAVIOURAL FINANCE

(All sections / Groups)

9th FEBRUARY 2023
9.00 a.m. – 11.00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This Questions paper consists of 2 pages with 2 Questions only.
2. Attempt **ALL** questions. The distribution of the marks for each question is given.
3. Please write all your answers in the Answer Booklet provided.

QUESTION 1 (50 MARKS)

(a) Explain the expected utility theory under Allais paradox with relevant examples. (25 marks)

(b) "If such market anomalies persist, those anomalies argue for inefficiency of markets." Define anomalies and briefly discuss the cause of anomalies. (25 marks)

QUESTION 2 (50 MARKS)

Prior to the COVID-19 pandemic, regulators were already aware of the difficult and complex decisions retail investors must make, often on their own, when choosing investments. Many individuals struggle with the complexity of investment decisions and may not fully appreciate the level of risk they are taking. For example, in the United Kingdom, 57% of adults report low financial capability or find it hard to find suitable financial products or services. In the United States, investing knowledge, as measured by five questions in a 2020 survey conducted by the FINRA Foundation and the National Opinion Research Center (NORC) at the University of Chicago, is low for all groups, but particularly for first-time account openers, potentially leaving these newer investors unprepared to make sound investment decisions in their new accounts. Beyond knowledge, investment decisions can be influenced by other factors that were also present pre-pandemic. For example, both the way choices are presented and a host of well-established behavioural biases can negatively affect investment decisions. Although some of these potential biases could be addressed through investor education, addressing them in a more comprehensive way may require regulatory and supervisory action, thus making it clear that investor education outcomes are more likely to be achieved in a context of proper regulation and efficient oversight. The pandemic raised concerns about the vulnerability of investors across all age groups in an increasingly digitalized world, particularly in the context of physical social isolation, the continuing rise of social media, commission-free trading, and the ability to trade fractional shares in some jurisdictions. In short, the COVID-19 period has seen, among others; high levels of market volatility, more investors trading for themselves, an increase in gamification of investing, an increased reliance on social media for advice, an increase in fraud and scams.

Source: The International Organization of Securities Commissions

a) Based on the above article, briefly explain **FIVE (5)** investors' cognitive biases with appropriate examples. (30 marks)

b) Describe the action taken by investors by applying the concepts of prospect theory developed by Daniel Kahneman and Amos Tversky. (20 marks)

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